

Minneapolis Community Development Agency

## Request for City Council Action

Date: October 28, 2002

To: Council Member Lisa Goodman, Community Development Committee

Forward to: MCDA Board of Commissioners

Prepared by Cynthia Lee, Manager, Multi-Family Housing Division, Phone 673-5266

Approved by Chuck Lutz, MCDA Interim Executive Director \_\_\_\_\_

**SUBJECT: Proposed Second Mortgage Terms for Affordable Multifamily Ownership Housing Units**

**Previous Directives:** None.

**Ward:** City-wide

**Neighborhood Group Notification:** Not applicable.

**Consistency with *Building a City That Works*:** Consistent with Goal 2, objective H, "Ensure that an array of housing choices exists to meet the needs of our current residents and attract new residents to the city; increase homeownership."

**Comprehensive Plan Compliance:** Complies.

**Zoning Code Compliance:** Not applicable.

**Impact on MCDA Budget:** No impact.

**Living Wage / Business Subsidy:** Not applicable.

**Job Linkage:** Not applicable.

**Affirmative Action Compliance:** Not applicable.

**Recommendation:**

**City Council:** Approval of second mortgage terms for affordable multifamily ownership housing units.

Crown Roller Mill,  
105 Fifth Ave. S., Suite 200  
Minneapolis, MN 55401-2534  
Telephone: (612) 673-5095  
TTY: (612) 673-5154  
Fax: (612) 673-5100  
[www.mcda.org](http://www.mcda.org)

**MCDCA Board of Commissioners:** Approval of second mortgage terms for affordable multifamily ownership housing units.

Under the city's Affordable Housing Policy, ownership housing projects of 10 or more units must create a financing mechanism to make at least 20% of those units affordable at <50% of median income. A second mortgage strategy is needed for the affordability assistance for those units.

MCDCA has been working with a group of experienced housing professionals to design appropriate second mortgage terms for affordable multifamily ownership housing units. There are a number of ways to structure second mortgage assistance, depending on the goals that the city is trying to achieve. We understand that one of the city's primary goals is long-term affordability of the original housing unit. The working group spent quite a bit of time researching this issue and exploring other models used around the country. This group of has arrived at a solid, workable model that is intended to meet the city's primary goal, plus a secondary goal of simplicity of administration.

This model is intended as a preferred approach to structuring financing for affordable multifamily ownership projects. It is project-specific and site-specific at this time and will not necessarily replace existing second mortgage program guidelines such as those used for the GMHC Homeownership program. This approach will be used for multifamily affordable ownership projects, all of which have some defined source of affordability financing specifically for that project (TIF, MHFA, NRP, EZ, etc.). It will be used for all affordable units, not just the required units at <50%. The maximum loan amount (or amounts if there are different levels of affordability) will be determined on a project by project basis.

- Term: the loan will be structured with a 40-year term. At maturity, the loan principal is due but all accrued interest is forgiven as long as the property has continued to be owned and occupied by low-income buyers. The seller should not incur taxes on forgiven accrued interest as long as they have not deducted accruing interest over time.
- Interest rate: 3% fixed, simple interest.
- Assumption: the loan is assumable only if the new purchaser is a qualified low-income buyer and owner occupant, in which case the accrued interest is forgiven.
- Amount: equal to the affordability gap, based on the buyer's first mortgage capacity (using non-aggressive underwriting criteria that do not put buyer at the absolute loan maximum) subtracted from the sales price (market value). MCDCA will establish a maximum second mortgage amount for each project.
- Lender: originally the developer will act as the lender, however loans will be assigned to a permanent lender entity (MCDCA or, as suggested for our TIF loans, Family Housing Fund).

- Other: qualified low-income buyers will be sought from home buyer workshops and other similar sources.

This approach provides for long-term affordability by creating an incentive to sell to a new low-income buyer. If the unit does not sell to a low-income buyer, the lender recaptures the subsidy (plus interest) to apply to another affordable housing unit elsewhere. It also allows owners access to the same level of appreciation as any other owner. The 40 year term is structured to prevent the balloon payment hitting at the same time as the end of the first mortgage term. The loans are non-recourse so that repayment occurs only to the extent there are proceeds. The loans will be subordinate to first mortgage debt but not necessarily other soft debt, subject to individual circumstances. If the buyer later refinances the first mortgage, the subordination request would be subject to the existing MCDA subordination policy and procedure.

The working group explored the concept of equity-sharing as an alternative to fixed interest. Any model for a deferred second mortgage can create confusion for the borrower because of the difficulty of comprehending the accrual of interest. MCDA has, however, found that simple interest loans are more understandable to the borrower than the equity sharing loans and there is much less buyer resistance. The Family Housing Fund, in fact, used an equity-sharing model in the past, but they converted to 3% simple interest, primarily for the above reasons.

This approach should be fairly straightforward for buyers and future administrators and seems to address most of the city goals we initially identified. This model would be used for all MCDA TIF, NRP, EZ and MHFA second mortgage affordability loans according to a set of consistent loan documents. The Lofts on Arts Avenue project is expected to be the first to use this model.

This report was prepared by Cynthia Lee. For more information, call 612-673-5266.